

STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF FINANCIAL EXAMINATION

of

**ALPHA DENTAL OF UTAH, INC.**

of

Salt Lake City, Utah

as of

December 31, 2008

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July 22, 2009

Honorable D. Kent Michie  
Insurance Commissioner  
Utah Insurance Department  
3110 State Office Building  
Salt Lake City, UT 84114

Commissioner:

Pursuant to your instructions and in compliance with statutory requirements, an examination, as of December 31, 2008, has been made of the financial condition and business affairs of:

Alpha Dental of Utah, Inc.  
Salt Lake City, Utah

a limited health plan, hereinafter referred to in this report as the Organization, and the following report of examination is respectfully submitted.

#### SCOPE OF EXAMINATION

##### Period Covered by Examination

The current examination covers the period from January 1, 2006, through December 31, 2008, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination.

##### Examination Procedure Employed

The examination included a general review and analysis of the Organization's operations, the manner in which its business was conducted, and a determination of its financial condition as of December 31, 2008. The examination was conducted in accordance with the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook using the new risk focused approach. The examination included the review of corporate records, accounting practices to determine compliance with applicable laws of the state of Utah, insurance rules promulgated by the Utah Insurance Department (Department) and the NAIC Accounting Practices and Procedures Manual.

The organization retained the services of an independent certified public accounting firm, Armanino McKenna, LLP, to audit its financial records for the years under examination. Copies of audit reports and working papers for the years 2006 through 2008 were made available to the examiners' use. Information evidencing the

assessment of fraud risk, evaluation of information systems and substantive testing on accounts and records were relied upon for examination purposes to the extent they were determined applicable.

A letter of representation certifying that management disclosed all significant matters and records was obtained from management and is included in the examination working papers.

#### Status of Prior Examination Findings

The previous examination was performed by the Department as of December 31, 2005. There were no items of significance or adverse findings noted in the prior examination report.

### HISTORY

#### General

The Organization was incorporated on April 22, 1991 and it was issued a certificate of authority under the name of Associated Dental Plans, Inc. effective June 5, 1991. It commenced business on July 1, 1991. The revised articles of incorporation, dated March 26, 1991, authorized the issuance of 100,000 shares of common stock with a par value of \$.10 per share.

During April 1991, surplus notes in the aggregate of \$30,000 were issued to three individuals. The individuals transferred their interest in the notes to Associated Companies, Inc., effective November 1, 1992. The three surplus notes were cancelled and one \$30,000 note was issued to Associated Companies Inc. to implement the transfer of interest. The \$30,000 note was retired, effective December 31, 1992, in return for 84,000 shares of the Organization's common stock.

Private Medical-Care, Inc. (PMI) acquired the Organization's outstanding shares of common stock on October 1, 1993. As consideration, PMI paid \$30,000 in cash, and it agreed to pay specified percentages of gross premium collected through December 31, 1996, from dental plan contracts.

Articles of amendment to the articles of incorporation changing the name of the Organization to Delta Care Dental Plan, Inc. were executed on December 8, 1993. Articles of amendment to the articles of incorporation changing the name of the Organization to Alpha Dental of Utah, Inc. were executed on February 27, 2006. The updated certificate of authority became effective March 1, 2006.

Effective January 1, 2007, the Organization's parent and owner, PMI was merged into Delta Dental of California. Delta Dental of California is PMI's parent company and the ultimate controlling entity.

## Capital Stock

As of December 31, 2008, the number of shares of common stock authorized by the organization was 100,000 at a par value of \$.10 per share. The number of shares issued and outstanding was 100,000. The balance in the common stock account was \$10,000. The balance in the paid in surplus account was \$119,552. Delta Dental of California owned 100% of the outstanding shares.

## Dividends to Stockholders

No dividends were paid to the stockholder during the examination period.

## Management

The bylaws of the Organization indicated the number of directors shall be no less than three or more than nine. The following persons served as directors of the Organization as of December 31, 2008:

<u>Name</u>	<u>Principal Occupation</u>
Garry D. Radine, Chairman	President/CEO Delta Dental of California
Michael J. Castro	Executive Vice President and CFO of Delta Dental of California
Patrick S. Steele	Executive Vice President and Chief Information Officer of Delta Dental of California
Marilynn G. Belek, DMD	Executive Vice President and Chief Dental Officer of Delta Dental of California
Jeffrey M. Album	Director of Public Affair of Delta Dental of California
Michael B. Kaufman	Senior Vice-President Delta Dental of California

The officers of the Organization as of December 31, 2008, were as follows:

<u>Principal Officer</u>	<u>Office</u>
Anthony S. Barth	President/Chief Executive Officer
Belinda Martinez	Vice President
Melissa K. Gee Esq.	Secretary
Michael J. Castro	Treasurer
Karen L. Robinson	Assistant Secretary
Philip J. Runnoe	Assistant Treasurer
Marilyn G. Belek, DMD	Chief Dental Officer

No committees of the Organization's directors functioned during the examination period. The audit committee of the parent, Delta Dental of California performed this function for its subsidiaries.

#### Conflict of Interest Procedure

The Organization has an established procedure for disclosure to its board of directors of any material conflicts of interest on the part of its officers, directors or responsible employees on an annual basis. Upon review of the biographical data and signed conflict of interest statements signed by the members of the board of directors and officers, the examiners found no significant conflict of interest disclosed by the Organization's directors and officers during the examination period.

#### Corporate Records

The minutes of the meetings of the stockholders and directors adequately approve the Organization's transactions and events during the examination period. The Organization's assistant secretary provided the Department a certification attesting that the prior examination report has been furnished to each director. The certification was dated December 6, 2006.

#### Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance

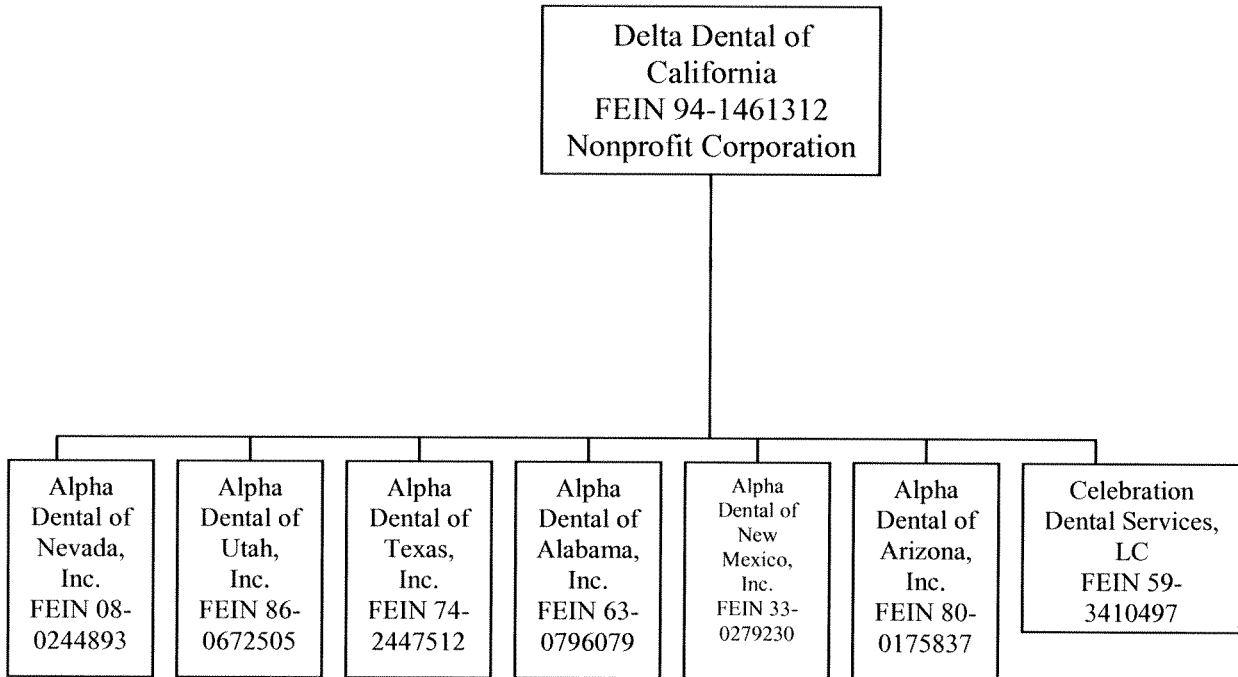
The Organization was not involved in any major corporate event during the period under examination.

#### Surplus Debentures

There were no Debentures issued or retired during the period under review, nor were any outstanding as of the current examination date.

## AFFILIATED COMPANIES

The Organization is wholly owned and controlled by Delta Dental of California. An organizational chart illustrating a subset of the Organization's holding company system, which just includes the direct parent follows:



### Transactions with Affiliates

Effective January 1, 2007, the Organization entered into a management agreement with Delta Dental of California, its direct parent, whereby the parent will have the exclusive authority to manage, conduct, supervise and administer the day-to-day operations of the Organization. The parent shall ensure the compliance with all statutory and regulatory requirements that govern both entities.

Article III Section 3.1 Administrative Costs, states, "Delta Dental shall be responsible for administrative costs and expenses incurred by it in providing the services required under the agreement, except for the following costs and expenses which shall be reimbursed by Alpha:

- (a) The direct costs and expenses charges by the Delta Dental to Alpha for office, marketing, professional relations, and management services rendered in Utah pursuant to the agreement; and
- (b) A percentage of Delta Dental's indirect administration costs allocated to Alpha."

Section 3.2 Program Costs states "Alpha shall bear full financial responsibility for the following:

- (a) Compensation and reimbursement paid to providers;

- (b) Commissions due to agents; and
- (c) Taxes or other governmental obligations imposed on Alpha.”

The Organization experienced significant growth in its membership, as reported in the 2008 annual statement. This growth and its related claims experience resulted in an underwriting loss for the same year. The examination noted that for this same 2008 period, the administrative expenses inexplicably went down. Further review of the administrative expenses identified a reversal of administrative costs of approximately \$25,000 accrued over a twelve-month period, back to Delta Dental of California. This reversal was noted as a waiver of administrative expenses. This reversal transaction as discussed in Statement of Statutory Accounting Principals (SSAP) No. 25 paragraph 17 of the NAIC Accounting Practices and Procedures (AP&P) Manual, could be characterized as a capital contribution, and thus the financial statements do not accurately describe the financial condition of the Organization.

U.C.A. § 31A-16-106(1)(a) states, “Transactions within a holding company system to which an insurer subject to registration is a party are subject to the following standards: ... (iii) expenses incurred and payment received shall be allocated to the insurer in conformity with customary insurance accounting practices consistently applied.” Additionally, the Organization is responsible for direct costs and expenses, a percentage of the parent’s indirect administrations costs, and program costs in accordance with Article III of the Management Agreement.

#### FIDELITY BOND AND OTHER INSURANCE

The minimum fidelity coverage suggested by the National Association of Insurance Commissioners (NAIC) for a company of the Organization’s size is between \$25,000 and \$50,000. As of the examination date, the Organization was a named insured by endorsement on a fidelity bond issued to Delta Dental of California. The Organization also had additional insurance protection against professional liability risks.

#### PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The organization did not have any employees. Delta Dental of California administered the operations of the Organization. Therefore, the Organization did not have pension, stock ownership, or insurance plans.

#### STATUTORY DEPOSITS

The Organization’s statutory deposit requirement was \$12,500 pursuant to Utah Code Annotated (U.C.A.) § 31A-8-211(3). The examination confirmed the Organization maintained a statutory deposit consisting of a certificate of deposit with a market value of \$31,200 which was adequate to cover the required deposit



## INSURANCE PRODUCTS AND RELATED PRACTICES

### Policy Forms and Underwriting

As of December 31, 2005, the policies issued by the Organization consisted of prepaid dental plans that provided coverage for specified general procedures. A compliance review of the policy forms was not performed.

### Territory and Plan of Operation

The Organization has a certificate of authority authorizing it to operate as a limited health plan in the state of Utah. The Organization does not operate in any other jurisdictions. The Organization administers and underwrites prepaid dental programs under agreements with employers and panel providers. The market for managed care dental products in Utah is not very substantial. Much of the companies products are sold on a dual choice basis.

The Organization's product is marketed in Utah through employees of the parent company, Delta Dental of California. Plan membership increased significantly as evidenced by the increase in premiums from \$56,045 in 2007 to \$152,109 by the end of 2008. It enrolled two large groups to the membership base. Total members increased from 524 to 1,916 as of December 31, 2008.

### Advertising and Sales Material

During the examination period, the Organization pursued a national marketing campaign. The Organization generates proposals for each group and does not use preprinted advertising material.

### Treatment of Policyholders

There were no formal complaints filed with the Department during the examination period.

## REINSURANCE

The Organization did not assume or cede reinsurance during the examination period.

## ACCOUNTS AND RECORDS

Most of the functions necessary for the Organization's Operation were performed by employees of its parent, Delta Dental of California. The Organization's records were maintained and processed in either Cerritos, or San Francisco, California, because it

obtained permission from the commissioner through an order dated October 5, 1993, to maintain its principal place of business in California.

Upon review of the Organization's accounts and records pertaining to its short-term investments, a one year certificate of deposit in the amount of \$31,211 is presented as short term investment on Line 5 of the 2008 Annual Statement, with a reference to Schedule DA, which is not in the Annual Statement. This certificate of deposit serves as the statutory deposit with the state of Utah. According to the NAIC 2008 Health Annual Statement Instructions, "certificates of deposit in banks or other similar financial institutions with maturity dates of one year or less from the acquisition date" are classified as cash for financial statement purposes, in accordance with the NAIC 2008 Accounting Practices & Procedures Manual Statement of Statutory Accounting Principles (SSAP) No. 2, Cash, Drafts, and Short-term Investments.

## FINANCIAL STATEMENTS

The following financial statements were prepared from the Organization's accounting records and the valuations and determination made during the examination:

BALANCE SHEET as of December 31, 2008

STATEMENT OF REVENUE AND EXPENSES for the Year Ended  
December 31, 2008

RECONCILIATION OF CAPITAL AND SURPLUS – 2006 through 2008

The accompanying NOTES TO FINANCIAL STATEMENTS are an integral part of the financial statements.

ALPHA DENTAL OF UTAH, INC.  
BALANCE SHEET  
as of December 31, 2008

ASSETS	Net Admitted	
	Assets	Notes
Bonds	-	
Cash and Short-term Investments	\$ 251,429	
Subtotals; cash and invested assets	251,429	
Uncollected premiums and agents' balances in course of collection	111	
Receivables from parent; subsidiaries and affiliates	25,249	
TOTALS	<u>\$ 276,789</u>	
<b>LIABILITY AND SURPLUS</b>		
Claims unpaid (less \$0 reinsurance ceded)	\$ 47,705	
Unpaid claims adjustment expenses	474	
Premiums received in advance	16,687	
General expenses due or accrued	2,845	
Total liabilities (Lines 1 to 21)	<u>\$ 67,711</u>	
Common capital stock	10,000	
Gross paid in and contributed surplus	119,552	
Unassigned funds (surplus)	79,526	
Total capital and surplus	209,078	(1)
TOTAL LIABILITIES, CAPITAL AND SURPLUS	<u>\$ 276,789</u>	

ALPHA DENTAL OF UTAH, INC.  
STATEMENT OF REVENUE AND EXPENSES  
for the Year Ended December 31, 2008

	<u>Total</u>
Member months	18,898
Net premium income	\$ 152,109
Aggregate write-ins for other health care related revenue	15,445
Total revenues	167,554
Hospital and Medical:	
Other professional services	284,387
Outside referrals	<u>2,752</u>
Subtotal	287,139
 General administrative expenses	 <u>7,410</u>
Total underwriting deductions	<u>294,549</u>
Net underwriting gain or (loss)	<u>(126,995)</u>
Net investment income earned	<u>9,861</u>
Net investment income gains or (loss)	9,861
 Net income or (loss); after capital gains tax and before all other federal income taxes	 (117,134)
Federal and foreign income taxes incurred	<u>1,534</u>
Net income (loss)	<u><u>\$ (118,668)</u></u>

ALPHA DENTAL OF UTAH, INC  
RECONCILIATION OF CAPITAL AND SURPLUS  
2006 through 2008

	<u>2006</u>	<u>2007</u>	<u>2008</u>
Capital and Surplus	\$ 318,346	\$ 311,646	\$ 327,746
Increase (decrease) in common stock			
Increase (decrease) in contributed capital			
Net Income or Loss	(6,700)	16,100	(118,668)
Surplus Adjustments: Paid In			
Rounding			
Net change in Capital and Surplus	<u>(6,700)</u>	<u>16,100</u>	<u>(118,668)</u>
Capital and Surplus	<u>\$ 311,646</u>	<u>\$ 327,746</u>	<u>\$ 209,078</u>

## NOTES TO FINANCIAL STATEMENTS

### (1) Capital and surplus

\$ 209,078

The Organization's minimum capital requirement was \$10,000 as defined in U.C.A. § 31A-8-209 (2) (b). As defined by U.C.A. § 31A-17 Part 6, the Organization had total adjusted capital of \$209,078, which exceeded the company action level Risk Based Capital (RBC) requirement of \$25,023 by \$184,055.

## SUMMARY OF EXAMINATION FINDINGS

Items of significance commented on in this report are summarized below:

1. A one year certificate of deposit in the amount of \$31,211 is presented as short term investment in Line 5 of the 2008 Annual Statement, with a reference to Schedule DA, which is not in the Annual Statement. This certificate of deposit serves as the statutory deposit with the State of Utah. According to the NAIC 2008 Health Annual Statement Instructions, "certificates of deposit in banks or other similar financial institutions with maturity dates of one year or less from the acquisition date" are classified as cash for financial statement purposes, in accordance with the NAIC 2008 Accounting Practices & Procedures Manual SSAP No. 2, Cash, Drafts, and Short-term Investments.

### *Recommendation*

Since reclassification of the asset will not affect the Organization's Risk Based Capital, it is recommended this type of investment should be classified as cash instead of as a short-term investment. (ACCOUNTS AND RECORDS)

2. The examination identified a reversing journal entry in December 2008 general ledger, which was a reversal of administrative costs of approximately \$25,000 accrued over a twelve-month period, back to Delta Dental of California. This reversal was noted as a waiver of administrative expenses. This reversal transaction as discussed in SSAP No. 25 paragraph 17 of the NAIC AP&P Manual, could be characterized a capital contribution, and thus the financial statements do not accurately describe the financial condition of the Organization. This transaction did not comply with U.C.A. § 31A-16-106(1)(a)(iii) nor did it comply with Article III of the Management Agreement. (Transactions with Affiliates)

### *Recommendation*

The Organization should account for transactions with affiliates in accordance with SSAP No. 25 paragraph 17 to comply with U.C.A. § 31A-16-106(1)(a)(iii).

## ACKNOWLEDGEMENT

The assistance and cooperation extended during the course of the examination by the officers, employees and representatives of the Organization is sincerely appreciated. Hermoliva B. Abejar and David L. Flores, CPA, CFE, participated in the examination, Jake Garn, CPA, MBA, AFE, Chief Examiner and Colette M. Hogan Sawyer, CFE, CPM, Assistant Chief Examiner, performed supervisory oversight.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Donald R. Catmull". The signature is fluid and cursive, with a large, stylized initial "D".

Donald Catmull, CFE  
Utah Insurance Department